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Markets May Understate Obama's Odds

By JUSTIN WOLFERS

Barack Obama is the hot favorite to win Tuesday's election. Every recent poll, prediction market, forecasting equation and (non-partisan) pundit tips an Obama victory.

The Wall Street Journal's own fantasy prediction market gives Sen. Obama an [85% chance to win](#) on Tuesday, echoing the assessments made in real money prediction markets run by [Intrade](#), [BetFair](#) and the [Iowa Electronic Markets](#). Markets linked to the likely winning margin suggest that the Democratic nominee is likely to win [about 54% of the popular vote](#).

The polls also tell a similar story. The poll of polls conducted by both [RealClearPolitics](#) and [Pollster.com](#) currently gives Sen. Obama around a six-point lead in the popular vote. While Republicans have been hoping that each day's data will signal the beginning of a new trend, the support for Sen. Obama has been remarkably stable, and his lead has exceeded five points throughout October.

All told, these indicators suggest very little chance that John McCain will win.

In fact, I suspect that the prediction markets currently understate the likelihood of an Obama victory. My reasoning is based on a phenomenon that behavioral economists call the "favorite-longshot bias." In essence, people tend to overbet unlikely outcomes. So the odds often overstate the chances of a longshot (like McCain) winning, and conversely understate the chances of the favorite.

Most of the previous evidence of the favorite-longshot bias came from [analyzing horse-race betting markets](#). But recently, Andrew Leigh, Eric Zitzewitz and I have turned to assessing whether a similar bias affects political prediction markets. Our findings -- while preliminary -- show that it is exceptionally rare that political underdogs win. When political races are close, this bias isn't so important. But in lopsided contests, prediction markets really tend to overstate the support for underdogs.

In fact, our best estimates suggest that when election-eve prediction markets suggest a [15% chance of victory](#) -- as they presently do for Sen. McCain -- the true probability may be as low as 4%. Thus, Sen. Obama is not quite a sure thing -- but he's close.

Of course, some underdogs do win, and so it is worth [revisiting the history of political underdogs](#) who succeeded against the odds. Some were the engineers of their own come-from-behind victories. Ronald Reagan's victory in 1980 -- catalyzed by a stunning debate victory a week prior to the election -- is an instructive example. Unfortunately for Sen. McCain, however, all three debates are behind him. In the few remaining days, there is nothing on the political calendar important enough to inspire a sharp change in momentum.

In other cases, upset victories reflected pundits making over-confident predictions based on insufficient data. Two weeks prior to the famous 1948 election, Thomas Dewey was so far ahead of Harry Truman that pollsters simply stopped measuring public opinion. Similarly, the pundits who prematurely counted Hillary Clinton out of this year's Democratic primary in New Hampshire did so despite [somewhat mixed polling](#) over the preceding weeks and very sparse polling in the final days.

But next Tuesday's election is surely the most tracked race in history, and literally tens of thousands of voters across the country are being polled every day, with extra attention paid to swing states. A stealth victory seems unlikely, although there remains a question as to whether [a Bradley-Wilder effect](#) has distorted the polling numbers.

More common are those cases when external political events sharply shift the political narrative, such as the ouster of the Spanish government in the aftermath of the 2004 Madrid train bombings. The events of September 11th also had a major impact on the subsequent Australian election, as did a concurrent immigration controversy. Realistically, this type of shock is McCain's last hope, yet the rush to early voting has also blunted the possible impact of any last minute shock.

As each day passes, the likelihood of such an external event reshaping this election declines. Consequently, it is likely that Sen. Obama's stock price will slowly rise over the next few days, even if his polling numbers remain static or falls slightly.

How far apart are the polling and prediction market data? To my eye, they tell a similar story, and my adjusted assessment of the prediction markets -- suggesting that Sen. Obama has a 96% chance to win the election -- matches that of [FiveThirtyEight.com's Nate Silver](#), the current darling of the poll crunchers.

Our approaches differ. My assessment is based on a reading of the prediction markets, taking account of historical biases against the favorite. Mr. Silver's assessment is based on crunching data from countless state and national polls. But viewing the data through either lens, it is hard to see a path to a McCain victory.

This election is one of those rare instances in which polls, pundits, prediction markets and statistical forecasting models all point in the same direction. An Obama victory will surprise few; a McCain win would be a truly historic embarrassment for political prognosticators.

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